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1993

In The

Supreme Court of the United States

October Term, 1993

FRANCIS R. SABLONE, JR.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Does SEC Rule 10b-5 impose criminal sanctions for the "misappropriation" of information contained in a weekly periodical, when the only victim of the alleged fraud is the publisher of the periodical?

2. Can information contained in a weekly periodical be considered "non-public" and "confidential" for purposes of Rule 10b-5 when the information is voluntarily disseminated by the publisher prior to the "official" release time of the magazine and where the market already reflects trading on the information?

3. Does Rule 10b-5 prohibit trading on information until such time as the information has been "impounded" into the market price of the security involved?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner, Francis R. Sablone, Jr., respectfully requests that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Second Circuit. In addition to the parties listed in the caption, Benjamin B. Libera was a co-defendant in the action below.

DECISION BELOW

The decision of the United States Court of Appeals for the Second Circuit affirming the petitioner's conviction is reported at 989 F.2d 596 (2d Cir. 1993) and is reprinted in the Appendix at App. 2a-25a.

JURISDICTION

The decision of the Court of Appeals for the Second Circuit sought to be reviewed by way of this petition was rendered on March 22, 1993. A petition for rehearing was denied by the Court of Appeals on May 12, 1993. This Court has jurisdiction to review the judgment of the Court of Appeals under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

The principal statutory provisions involved in this appeal are 15 U.S.C. § 78j and 17 C.F.R. § 240.10b-5, the text of which are reprinted in the Appendix at App. 28a-30a.

STATEMENT OF THE CASE

This case presents the Court with the opportunity to resolve the questions left unresolved in *Carpenter v. United States*, 484 U.S. 19 (1987), and *Chiarella v. United States*, 445 U.S. 222 (1980). Although the creation of a "misappropriation" theory of securities fraud has never been adopted by this Court, the Court of Appeals for the Second Circuit has affirmed the convictions of the petitioner based on his purchase of securities while in possession of information allegedly wrongfully obtained by employees of a printing company. As in *Carpenter*, the petitioner's conviction is not based on the defrauding of any investor or corporate shareholder, but rather is grounded on the concept that the information had been "misappropriated" from its owner, a magazine publisher that had no ownership interest in the securities ultimately purchased by the petitioner. In that Rule 10b-5 was never intended to criminalize a purported breach of an internal corporate policy concerning the confidentiality of publishing information, review of both the validity of the misappropriation theory as well as its application to circumstances such as these - issues left open

after this Court's 1987 decision in *Carpenter* - are significant issues that require resolution by this Court.

This case also presents the Court with the question of the proper scope and definition of the terms "non-public" and "confidential" as they are used in civil and criminal actions founded on Rule 10b-5. Despite the uncontradicted evidence introduced at trial which revealed that (1) the magazine was voluntarily released by the publisher to other members of the media prior to the "official" release time of the magazine established by the publisher; and (2) the market reflected widespread trading on the information preceding the official release of the magazine by roughly forty-eight hours, the Court of Appeals held that the information in the petitioner's possession was "non-public" and "confidential." The question of whether information that was voluntarily released by its owner and in the public domain can legally remain both non-public and confidential is not one to be left for ad hoc determination on a case-by-case basis. The Court of Appeals's holding unnecessarily complicates this area of the law, an area that demands precision.

Finally, in affirming the petitioner's convictions, the Court of Appeals created a new element of securities fraud. The court held that the determination of whether information is "non-public" within the scope of Rule 10b-5 involves more than an analysis of whether the information has been disseminated to members of the public. According to the decision below, it is not only the number of people who possess certain information which determines whether it has become public, but also whether trading on that information has been "fully impounded" into the price of the security. In other words, in addition to investigating whether information is public, the average investor will also have to ensure that the information has already been "impounded" into the price of a stock, or risk criminal prosecution for securities fraud. Such a modification of the elements of securities fraud, as established by this Court in *Chiarella* and *Dirks v. S.E.C.*, 463 U.S. 646 (1983), is both unwarranted and unsound.

A. STATEMENT OF PERTINENT FACTS

The petitioner was indicted and charged with one count of conspiracy, fifty-nine counts of securities fraud and

twenty-six counts of mail fraud. After a trial before a jury, he was convicted on the conspiracy and securities fraud charges; the jury was unable to return a verdict on the remaining counts. During that trial, the following evidence was adduced:

Throughout 1987 and early 1988, the petitioner purchased securities on Thursdays based on information provided to him by his broker and by a friend, his co-defendant, Benjamin Libera. The information consisted solely of a report of which securities were mentioned in that week's issue of *BusinessWeek* magazine, a periodical published by McGraw-Hill, Inc. More specifically, the information given to the petitioner was contained in a weekly column appearing in *BusinessWeek*, "Inside Wall Street," which typically assessed three publicly traded companies each week. The petitioner testified that he was aware that copies of the magazine were being obtained from employees of R.R. Donnelley & Sons, a printing company in Old Saybrook, Connecticut, which printed the magazine in the early morning hours every Thursday. The petitioner also testified, however, that he believed that the employees were

permitted to take copies of the magazine home with them at the end of their shift early on Thursday morning, and that they then delivered the copy to either Libera or William Dillon in exchange for a nominal payment.

The government produced a representative of McGraw-Hill who testified that McGraw-Hill's corporate policy prohibited release of the magazine until after 5:00 p.m. on Thursdays. In turn, a representative of Donnelley testified that its corporate policy forbade employees from taking magazines out of the plant, unless specifically authorized to do so. The magazine itself bears no notation to the effect that it is not intended for release or public consumption until after 5:00 p.m. on Thursdays.

The government's key witness at trial was William Dillon, the man who first observed that the stocks of the companies reviewed in "Inside Wall Street" noticeably reacted to the publication of the magazine. Dillon testified that the trading volume in these securities would begin to ascend on Wednesday (the day before the magazine was "officially" released) soon followed by a increase in the price of the stock. This phenomenon was also acknowledged by

six other witnesses at trial, including the managing editor of *BusinessWeek* and a chief investigator from the Securities Exchange Commission. The petitioner was aware that the stocks were active on Wednesday, which knowledge contributed to his belief that the magazine was in the public domain when he obtained the information the following day, on Thursday.

In addition to the evidence of heavy trading activity on Wednesday, the managing editor of *BusinessWeek* and another McGraw-Hill employee testified to McGraw-Hill's practice of preparing hundreds of "press kits" each Thursday that were sent to members of the media that afternoon, prior to the "official" release time of the magazine. Each kit contained a press release, highlighting an especially noteworthy article contained in that week's edition of *BusinessWeek*, and a copy of the magazine. Although the press release bore a notation that the information highlighted was "for release after 5:00 p.m.," there was no warning to the recipients of the kit that they were forbidden to read the magazine itself or to use the information contained therein for any purpose, until after 5:00 p.m. Despite the fact that

the McGraw-Hill employees acknowledged at trial that there was no way for the publisher to control those copies of the magazine which were voluntarily disseminated to the media, the government contended that the petitioner's use of the information was improper because it remained "confidential" until McGraw-Hill's official release time of 5:00 p.m. on Thursday.

B. THE COURT OF APPEALS DECISION

Pursuant to section 1291 of title 28 of the United States Code, the petitioner appealed from his conviction arguing, *inter alia*, that, as a matter of law, the information in his possession when he purchased securities was neither nonpublic nor confidential based on the uncontroverted evidence that (1) the contents of the magazine were in the public domain as early as Wednesday; and (2) McGraw-Hill released the information of its own accord prior to the "official" release time it had established. Oral argument was heard on the appeal on June 9, 1992, before Circuit Judges Cardamone, Winter and Mahoney. The panel's decision, affirming the petitioner's convictions, was not released until

March 22, 1993, almost ten months after the appeal had been argued.

Relying principally on its 1986 decision in *Carpenter v. United States*, 791 F.2d 1024 (2d Cir. 1986), *aff'd by an equally divided court*, 484 U.S. 19 (1987), and its more recent decision in *United States v. Chestman*, 947 F.2d 551 (2d Cir. 1991)(en banc), *cert. denied*, 112 S. Ct. 1759 (1992), the Court of Appeals determined that the petitioner's conduct fell within its concept of the misappropriation theory of securities fraud. In doing so, the Court of Appeals specifically noted that the doctrine "prohibits trading in securities based on material, non-public information acquired in violation of a duty to any owner of such information, *whether or not the owner is the corporation whose shares are traded.*" App. at 14a (emphasis added). In the same breath, the court acknowledged, as it had earlier in *Chestman*, that this definition of the misappropriation theory was an expansion of Rule 10b-5 not yet the subject of a holding by this Court. *Id.*; *Chestman*, 947 F.2d at 566.

In reviewing the conviction, the Court of Appeals refused to consider the petitioner's argument that, as a

matter of law, the information which he had in his possession when he purchased securities was neither "non-public" nor "confidential," due to the uncontradicted evidence that McGraw-Hill voluntarily disseminated the information to members of the media and that the market activity reflected that the information was already in the public domain at the time the petitioner received it. Without explanation, the Court of Appeals elected to treat the petitioner's challenge not as one of law, but instead as one directed to the sufficiency of the evidence, ultimately determining that the jury could have found that the information was not "fully impounded" in the price of the securities at the time of petitioner's trades. This misinterpretation of the scope of the petitioner's challenge was one of the central bases of his petition for rehearing. The petitioner also sought rehearing on the ground that the "impoundment" element described in the majority's opinion was logically unsound. The petition for rehearing was denied by the Court of Appeals. App. at 26a-27a.

REASONS FOR GRANTING THE WRIT

A. RULE 10b-5 DOES NOT IMPOSE CRIMINAL SANCTIONS FOR THE "MISAPPROPRIATION" OF INFORMATION CONTAINED IN A WEEKLY PERIODICAL, WHEN THE ONLY VICTIM OF THE ALLEGED FRAUD IS THE PUBLISHER OF THE PERIODICAL.

In 1987, this Court was equally divided when presented with the question of whether Rule 10b-5 could be legally and logically extended to cover an alleged scheme to defraud one who was neither a shareholder nor a prospective stock trader. *Carpenter*, 484 U.S. 19 (1987). This case presents the Court with a second opportunity to clarify the scope of the misappropriation theory created by the Court of Appeals for the Second Circuit in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983), as well as the application of that theory to an alleged fraud perpetrated on non-market participants. The petitioner urges that the day for review of the misappropriation theory has come, as predicted by Justice Stevens in his concurring opinion in *Chiarella*, 445 U.S. at 238.

Here, as in *Carpenter*, the only basis for the petitioner's securities fraud conviction was the violation of a magazine publisher's internal corporate policy. Furthermore, unlike the victims in other misappropriation cases, the only alleged victim of the petitioner's purported fraudulent scheme was the magazine publisher, McGraw-Hill, which undeniably lacked any interest in the purchase, sale or value of any of the securities traded by the petitioner. *Cf. SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985)(owner of misappropriated information was contemplating tender offer); *Newman*, 664 F.2d at 15 (same).

Finally, the only alleged harm from the so-called fraudulent scheme was the deprivation of McGraw-Hill's intangible right to keep secret the information contained in the magazine or to release the information at its whim, accompanied by whatever loss of reputation McGraw-Hill purportedly suffered by the revelation of the fact that it had difficulty enforcing its own corporate policies. As cogently stated by Justice Miner in his dissent from the Court of Appeals decision in *Carpenter*, "[h]arm to reputation, rather

than to securities markets or market participants, never has been recognized as a property subject for redress under section 10(b) or rule 10b-5." *Carpenter*, 791 F.2d at 1037 (Miner, J., dissenting).

The federal securities laws were never intended to enforce internal corporate policies, such as the one adopted (and loosely enforced)[1] by McGraw-Hill in this case. As this Court has stated, "[t]he Securities Act of 1933 . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing. . . ." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976). The continued application of the Second Circuit's

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[1] Not only was there testimony at trial that McGraw-Hill was well aware of the "early" trading on the "Inside Wall Street" contents and was apparently unable to halt it, but there was also testimony that the printing company, R.R. Donnelley, had experienced similar "leaks" of pre-publication copies of *BusinessWeek* at its West Coast location.

misappropriation theory to cases such as this, however, does nothing to further Congress's intent in enacting the securities laws. What the government asks is no more than a federal forum to allow McGraw-Hill to enforce its confidentiality policy. This Court has consistently interpreted such claims to fall outside the reach of federal securities law. "We thus adhere to the position that 'Congress by § 10 (b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement.' *Superintendant of Insurance v. Bankers Life & Cas. Co.*, 404 U.S., at 12 [1971]." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977)(exhibiting "reluctance to federalize" state law violations).

In *Chiarella*, this Court rejected the theory that a violation of Rule 10b-5 occurs whenever one trades while in possession of information not available or accessible to other investors. 445 U.S. at 235. While the rejection of this "parity of information" theory may not undermine application of the misappropriation theory in all fraud cases, its impact on cases such as this and *Carpenter* is unmistakable. The only connection between the petitioner's

conduct and the stock market is that the petitioner was executing trades while in possession of information not yet known by other investors. There was never any claim that the petitioner owed *any* duty to other investors to reveal the information in his possession. Rather, any duty owed by the petitioner would run only to McGraw-Hill, inherited by the petitioner fifth-hand.[2] And, of course, McGraw-Hill had no interest in the securities traded by the petitioner, its interest lay only in the information in the petitioner's possession. In other words, although the government contends that the victim of the securities fraud was McGraw-Hill, McGraw-Hill was not defrauded of anything which was securities-

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[2] The initial duty to keep the contents of *BusinessWeek* confidential was alleged to have run from R.R. Donnelley to McGraw-Hill. The government's contention is that the duty passed along with the information from Donnelley to its employees, from the employees to Libera, from Libera to his stock broker and from the broker to the petitioner.

related, which would invoke the protection of Rule 10b-5.[3] Thus, it is plain that it is really protection of other investors which is the government's goal, which leads right back to the rejected parity-of-information theory. The government now has its hand on the knob to the back door, after this Court firmly shut the front door in *Chiarella*.

"To say that the 'publication schedule' of [*BusinessWeek*] was the non-public, confidential information stolen by the defendants is to extend the sweep of section 10(b) and rule 10b-5 beyond all reasonable bounds. Knowledge of publication dates simply is not the special securities-related knowledge implicated in the misappropriation theory." *Carpenter*, 791 F.2d at 1037 (Miner, J., dissenting). The unwarranted expansion of Rule 10b-5 begun in *Carpenter* and existing today does not

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[3] The logical extension of the government's theory of securities fraud in this case would reach any type of property theft even if the property was absolutely unrelated to securities. For example, if an individual stole someone's wallet and used the money to purchase stocks, that would be securities fraud under the government's application of the misappropriation theory.

correspond with the goals of Congress in enacting the securities laws and is unrelated to the protection of the average investor. This Court should accept review of this matter in order to restrict the application of Rule 10b-5 to only those situations involving fraud on a market participant.

B. AS A MATTER OF LAW, INFORMATION CANNOT BE "NON-PUBLIC" AND "CONFIDENTIAL" WITHIN THE MEANING OF RULE 10b-5 WHEN IT IS VOLUNTARILY RELEASED BY THE OWNER TO THOSE WHO HAVE NO DUTY TO KEEP IT SECRET AND/OR THE MARKET REFLECTS ACTIVE TRADING BASED ON THE INFORMATION.

For the petitioner to have been properly convicted, it was incumbent on the government to establish that the information in the petitioner's possession was both "non-public" and "confidential." *Carpenter*, 791 F.2d at 1031. The petitioner contends that these elements could not be established, as a matter of law, because of two critical, undisputed facts: (1) McGraw-Hill voluntarily released hundreds of copies of *BusinessWeek* on Thursday afternoons to members of the media, despite its own policy that the magazine not be distributed until 5:00 p.m.; and (2) heavy trading in the companies which were the subject of any given

week's edition of "Inside Wall Street" began on Wednesday, two full business days before *BusinessWeek* was "officially" released. These two facts, alone or in combination, establish that the information in the petitioner's possession when he purchased securities could not be considered to be either non-public or confidential.[4]

The petitioner does not complain of McGraw-Hill's decision to release the magazine in violation of its own embargo. As duly noted by this Court in *Carpenter*, the information was McGraw-Hill's to do with as it pleased. 484 U.S. at 26. The problem arises out of the dichotomy created between those who could apparently trade on the information with impunity -- McGraw-Hill and those media members who were freely given the information -- and those who face criminal prosecution for engaging in the same activity, like the petitioner. "It seems especially ludicrous for the

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[4] Although the Court of Appeals represented that "many" of the petitioner's trades were placed before McGraw-Hill released the media copies, the government did not introduce evidence of the *time* of any trade placed by the petitioner.

government to contend that the court should enforce the Wall Street Journal's conflict of interest policy prohibiting employees from trading on the basis of pre-publication information while conceding that the Journal itself is not prohibited from trading on such information." *Carpenter*, 791 F.2d at 1037 (Miner, J., dissenting).

The import of the fact of the vast distribution of *BusinessWeek* to the media is that, by voluntarily breaching its own policy against release of the magazine prior to the "official" time, McGraw-Hill could no longer claim an expectation that the information contained therein would remain private. Without that expectation, there could be no "confidential" information. *Dirks*, 463 U.S. at 655 n.14.

Indeed, even if McGraw-Hill had attempted to restrict the media's viewing of the magazine prior to 5:00 p.m., those individuals who received press kits had absolutely no obligation, fiduciary or otherwise, to abide by McGraw-Hill's wishes. Absent such a duty, there can be no dispute that any media recipient could have read "Inside Wall Street" and placed a trade, before 5:00 p.m., without apprehension. As recently recognized by the Court of Appeals for the

Second Circuit, "a fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information." *Chestman*, 947 F.2d at 567.

In addition to the voluntary release of the magazine to the media on Thursday afternoon, there was also uncontradicted evidence that trading in the companies at issue began on Wednesday, two full days before the information was "officially" released and one full day before the petitioner ever received it. In light of the active trading of these securities, it is simply disingenuous to claim that the information remained non-public and confidential until the magical time of 5:00 p.m. on Thursday. Although the Court of Appeals "agree[d] that information may be considered public for Section 10(b) purposes even though there has been no public announcement and only a small number of people know of it," App. at 20a, the Court took the issue no farther, ignoring the logical result of such a statement and the ramifications of that result on this case. Instead, the Court of Appeals opined that no matter how many people possess the information, the determinative issue is whether "their trading has caused the information to be fully

impounded in price." *Id.* Although the latter conclusion is addressed separately, *infra*, the preliminary issue of exactly "how public" information must be before it may be utilized by an investor remains undefined.

The Court of Appeals's decision to permit a jury to decide whether information is public or non-public given the facts of any particular situation deprives the securities laws of much-needed precision. By permitting a jury to resolve the question invites a subjective analysis: not whether the information was public, but rather "how public was it?"

The securities fraud provisions, which are strictly the creation of judicial interpretation, need to provide the trading public with guidelines adequate to allow them to conform their conduct to the law. By delegating to a case-by-case analysis the resolution of whether information is sufficiently "public" to permit trading, the Court of Appeals has failed to offer the sharp delineation demanded by this field of regulation. This is not an area where subjectivity should rule; an objective analysis of whether information is public, as a matter of law, is required so that the average trader can know whether the data in his possession is legitimate. This

is especially necessary where, as here, the information itself appears to be in the public domain (being contained in a magazine intentionally distributed for the purpose of common consumption) and there is no independent way to determine whether the information is considered confidential.[5]

C. A DETERMINATION OF WHETHER INFORMATION IS PUBLIC WITHIN THE MEANING OF RULE 10b-5 SHOULD NOT INCLUDE AN ANALYSIS OF WHETHER THE INFORMATION HAS BEEN "IMPOUNDED" INTO THE PRICE OF THE SECURITY.

In its discussion of whether the *BusinessWeek* information was nonpublic and confidential, the Court of Appeals acknowledged that "information may be considered public for Section 10(b) purposes even though there has been no public announcement and only a small number of people know about it." App. at 20a. However, according to the same decision, a determination that the information is "public" in accordance with the above-stated definition, is no

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[5] Dillon testified at trial that he contacted both McGraw-Hill and Donnelley in an effort to determine when *BusinessWeek* was released on the newsstands, but neither company would provide this information to him.

longer sufficient: The trading may *still* be illegal if the information has not yet been "fully impounded" into the price of the particular stock. *Id.*

The concept that the information must be "fully impounded" in the price of a given security is new to the area of securities fraud. No such element can be found in this Court's seminal decisions in the area, *see, e.g.*, *Carpenter*, 484 U.S. 19; *Dirks*, 463 U.S. 646, nor was this element mentioned in the Court of Appeals's most recent, and comprehensive, decision on the misappropriation doctrine. *Chestman*, 947 F.2d at 566.

The introduction of a new factor to be considered when determining the guilt of one charged with a violation of the securities law merits a full discussion of relevant principles as well as the provision of a meaningful definition of that new element. The Court of Appeals's decision offers neither. The announcement that, in addition to being public knowledge, the information must also be "fully impounded" in the price of the security before trading is legal was made almost in passing, within the space of a paragraph, with no citation to any supporting authority.

Even if the "impoundment" theory is viewed merely as a new way to define the "public nature" of information, it fails logically. Rather than focus on whether the information has been released into the public domain, the Court of Appeals's analysis is instead concerned with the recipients' use of the information. Under this new impoundment theory, if a piece of material information is widely disseminated and available for unrestricted use, but few individuals trade on that information, then the price of the security will never reflect the absorption of the information and there will be no "impoundment." Thus, trading that would otherwise be legal becomes illegal.

On the other hand, if a piece of material information is mistakenly circulated among relatively few individuals but it generates a great deal of trading so as to assimilate the release of the information into the stock's price, then one who otherwise would be trading on nonpublic, confidential and material information in violation of current securities regulations may legitimately purchase that security. Thus, what is now illegal becomes legal.

The Court of Appeals also neglected to address the fact that the jury was never instructed to consider whether the information had been "impounded" into the price of the security in that this element was not yet in existence. Therefore, the Court of Appeals was incorrect when it stated that "the jury was correct in finding that the information was not fully impounded in the price at the time of appellants' trades." App. at 21a. The Court of Appeals was also in error in representing that the petitioner conceded "that the increase in trading volume and price of the securities in question continued after the release of the magazine to the general public." *Id.* No evidence was submitted by the government reflecting the movement of stock prices over the relevant period. Certainly, had the petitioner known that the government was obligated to establish that the information was "fully impounded" into the price of the stock before the petitioner could be found guilty, there would have been considerable evidence regarding stock market fluctuations. However, as neither the petitioner nor the government were

aware of the "impoundment" theory, there was no occasion for anyone to introduce such evidence.[6]

Once again, the Court of Appeals has forced a subjective determination of an issue which is best treated objectively. The average member of the trading public has no ready means of discovering when the price of a security has fully and finally absorbed the effect of any material information. Rather, it will be a jury which determines, in retrospect, whether trading was legitimate. This Court ought to consider the adoption of this new "impoundment" criterion by the Court of Appeals.

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[6] The closest evidence was given by Dillon who testified that his strategy was to purchase the security on Thursday morning and sell the security by Monday morning, when he believed the effect of the information was wearing off. The petitioner did not follow this strategy, instead retaining the stocks for days, weeks, even months. This testimony is far from specific evidence that, for every one of the 59 instances the petitioner was convicted of violating the securities fraud provisions, the information was not "fully impounded" until after 5:00 p.m. on Thursday afternoons. The petitioner in no way concedes the accuracy of Dillon's general observations and such testimony is insufficient to uphold the petitioner's convictions.

CONCLUSION

The issues decided by the Court of Appeals below are unique, but wide-ranging in effect. As earlier acknowledged by the Second Circuit Court of Appeals, cases such as this and *Carpenter* are "clearly beyond the pale of the traditional theory of insider trading." *Chestman*, 947 F.2d at 566. Unlike the norm, the petitioner is not an "insider" who traded on corporate information which he knew, or was reckless in not knowing, was confidential and would inevitably affect the price of the corporate securities. Rather, the petitioner placed trades using information which was contained in a weekly magazine. The information itself bore no indicia of secrecy, unlike advance knowledge of a tender offer, and there was no readily available means of determining whether the information was intended by its owner to remain confidential until a specified time. Despite the anomalous factual scenario, the effect of the Court of Appeals decision below is to criminalize -- as securities fraud -- any misuse of property which is so much as tangentially related to the purchase or sale of securities. Such a sweeping change, especially one which is not capable of

protecting other investors, was not the intent of Congress when it enacted the Securities Act.

In addition to providing an opportunity to review the scope of the misappropriation doctrine, review of this appeal is necessary to clarify the creation of the new element of securities fraud devised by the Court of Appeals: the requirement that information be "fully impounded" into the price of a security before one may legitimately trade. Absent review of this new requirement, other panels of the Second Circuit as well as all of the District Courts within this circuit, will be bound to adhere to this new definition of securities fraud. *See, e.g., Kremer v. Chemical Constr. Corp.*, 623 F.2d 786, 788 (2d Cir. 1980), *aff'd*, 456 U.S. 461, *reh'g denied*, 458 U.S. 1133 (1982).

For all of the above reasons, the petitioner, Francis R. Sablone, Jr., respectfully requests a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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**Counsel of Record*

August 10, 1993

No. _____

In The

Supreme Court of the United States

October Term, 1993

FRANCIS R. SABLONE, JR.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 1641, 1642--August Term, 1991

(Argued: June 9, 1992 Decided: March 22, 1993)

Docket Nos. 91-1741, 91-1750

UNITED STATES OF AMERICA,

Appellee,

-v.-

BENJAMIN B. LIBERA AND
FRANCIS R. SABLONE, JR.,

Defendants-Appellants.

B e f o r e:

CARDAMONE, WINTER AND MAHONEY,

Circuit Judges.

Appeals from convictions by a jury in the United States District Court for the District of Connecticut (Peter C. Dorsey, *Judge*) for conspiracy and insider trading. We conclude that appellants' trading as tippees of non-public, material information was illegal. We therefore affirm.

JOHN C. MCBRIDE, Boston, Massachusetts (Francis T. O'Brien, Jr., McBride, Wheeler & Widegren, Boston, Massachusetts, of counsel), *for Defendant-Appellant Benjamin B. Libera*.

JAMES A. WADE, Hartford, Connecticut (Linda L. Morkan, Robinson & Cole, Hartford, Connecticut, of counsel), *for Defendant-Appellant Francis R. Sablone, Jr.*

JOSEPH C. HUTCHISON, Assistant United States Attorney, New Haven, Connecticut (Albert S. Dabrowski, United States Attorney for the District of Connecticut, New Haven, Connecticut, of counsel) *for Plaintiff-Appellee*.

WINTER, *Circuit Judge*:

Benjamin B. Libera and Francis R. Sablone, Jr. appeal from their convictions by a jury before Judge Dorsey. Both were found guilty of conspiracy and of securities fraud for insider trading. Sablone's appeal raises the question whether, in an insider trading prosecution, the tipper must have known that his breach of a fiduciary obligation would lead to the tippee's trading on the misappropriated information. We answer in the negative. Both appellants challenge the sufficiency of the evidence regarding the breach of a fiduciary duty by the tipper and knowledge of that breach by the tippee. The evidence was sufficient. We therefore affirm.

BACKGROUND

Libera and Sablone were indicted by a grand jury on one count each of conspiracy in violation of 18 U.S.C. § 371 (1988). Libera was also charged with fifty-six counts of securities fraud in violation of 15 U.S.C. § 78j(b) (1988), and fifty counts of mail fraud in violation of 18 U.S.C. § 1341 (1988). Additionally, Sablone was charged with fifty-nine counts of securities fraud and fifty counts of mail fraud. Both appellants were found guilty of one count of conspiracy in violation of 18 U.S.C. § 371, and of fifty-six and fifty-nine counts, respectively, of securities fraud in violation of 15 U.S.C. § 78j(b).

Viewed in the light most favorable to the government, the evidence at trial demonstrated the following. R.R. Donnelley & Sons Co. ("Donnelley") operated a printing plant in Old Saybrook, Connecticut, which printed *Business Week*, a weekly publication owned by McGraw-Hill, Inc. The printing of *Business Week* began late Wednesday evenings and continued into Thursday.

Both McGraw-Hill and Donnelley follow a policy of keeping the contents of the weekly issue of *Business Week*

confidential until 5:00 p.m. on Thursday. This policy is explicitly based on the fact that the contents of the magazine may affect the price of particular stocks and, prior to release, are regarded as "inside" information by the Securities and Exchange Commission.[1] This policy had been in effect since at least 1981. In a letter dated April 17, 1987, the Distribution Manager for McGraw-Hill, Thomas Tully, communicated the confidentiality policy directly to Donnelley's Director of the Old Saybrook plant. Further, in a letter dated April 27, 1987, *Business Week* Editor-in-Chief

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[1] In a memorandum to the *Business Week* staff dated March 12, 1986, the Editor-in-Chief, Steven Shepard, stated:

For many years now, *Business Week* has had a policy that prohibits the distribution of early copies of the magazine on Thursday. The reason: because the magazine contains information that could affect the performance of stocks. The SEC considers such release to be inside information if it reaches anybody before it is released to the general public.

. . .Our policy is that the contents of the Magazine are off limits to anyone outside the *Business Week* staff until 5:00 pm EST on Thursday.

Steven Shepard communicated it directly to John B. Schwer, President of Donnelley. The letter stated:

> In view of recent widespread concern about insider trading, I thought it would be useful to remind you of some long-standing policies and procedures that *Business Week* expects all of its printers and other suppliers to follow.
>
> 1. The official release date of *Business Week* is 5 p.m. (New York Time) every Thursday. No public distribution of *Business Week* is permitted prior to that time, either by *Business Week* employees or any of its printers or other suppliers. Accordingly, please ensure that every person in your organization is instructed that they are not permitted to give anyone a pre-publication copy of *Business Week* before 5:00 p.m. (New York Time) on Thursday. Moreover, we would appreciate it if you would instruct all employees of your organization that they are not permitted to advise anyone about any information included in *Business Week* prior to 5:00 p.m. (New York Time) on Thursday.

Donnelley in turn informed its employees of the confidentiality policy. James Roddy, Human Resources Manager for the Old Saybrook plant, testified that new employees were advised at orientation of the need to maintain the confidentiality of customer materials. Employees also received a Donnelley handbook advising

them of the confidentiality policy. The handbook forbade even the discussion of the contents of magazines, much less their removal. Employee manuals placed at several locations throughout the plant contained similar warnings. In addition, a poster was placed in the employee entrance hallway stating that all customer materials were to be treated with absolute confidence. Donnelley also posted the April 17, 1987 letter from Tully. Guards were posted at the employee entrance and exit areas.

Accordingly, it was common knowledge among Donnelley employees that company rules forbade the removal of magazines from the plant. Indeed, every Donnelley employee who covertly provided early copies of *Business Week* to appellants and who testified stated that they knew of the confidentiality policy.

The government's case was that appellants traded in stock based on information in copies of *Business Week* delivered in violation of the McGraw-Hill/Donnelley confidentiality policy. That case was heavily dependent on the testimony of William Dillon, who had entered into a plea agreement involving two counts of wire fraud. According to

his testimony, Dillon's wife, Diana, brought home copies of *Business Week* on Friday mornings in early 1986 after her four-to-midnight shift at Donnelley. She told her husband that Donnelley forbade the employees from taking magazines out of the plant. Dillon began tracking the stocks of companies analyzed in Gene Marcial's "Inside Wall Street," a regular *Business Week* column. The column recommended investing in various companies based on Marcial's consultation with analysts and other sources. Dillon observed that the trading in favorably mentioned securities often began increasing in volume and price on the Wednesday before publication and continued through the next Monday.

Dillon's wife did not bring the copies of *Business Week* home until early Friday morning. This was well after the *Business Week* Thursday 5:00 p.m. release time but was perhaps nevertheless in violation of the Donnelley rule against removal of magazines. In any event, Dillon, recognizing the value of receiving a copy of *Business Week* even earlier, sought out another Donnelley employees, William Cobb. Cobb agreed to bring a copy of the

magazine, or simply a copy of the "Inside Wall Street" column, to the Monkey Farm Cafe at 9:00 a.m. on Thursday mornings after his shift. Dillon did not pay Cobb. Soon thereafter, Cobb changed shifts and an unidentified employee of Donnelley delivered the magazine to Dillon on one or two occasions. Dillon then approached William Sady, another Donnelley employee, who agreed to bring the magazine out at the end of his midnight-to-eight Thursday morning shift. Sady delivered the magazine to Dillon over an approximately two-year period at an initial price of $20 per copy. Dillon, of course, was using the "Inside Wall Street" information to trade on securities that were the subject of the column.

In the summer of 1986, Dillon approached appellant Brad Libera and told him that early investment in securities named in the "Inside Wall Street" column was a profitable strategy. Dillon also testified that he informed Libera that Donnelley employees were not supposed to remove copies of the magazine.

Libera then began to accompany Dillon to the magazine deliveries. On October 9, 1986, Libera invested in MCA based on *Business Week* information and thereafter

traded regularly in securities mentioned in the "Inside Wall Street" column. He executed a total of sixty-four Thursday trades in such stocks, resulting in a net profit of approximately $95,000. Between October 1986 and February 1987, Libera generally made the morning pick-ups alone because Dillon had entered a training program for stock brokers with Merrill Lynch. During this time Libera increased the payments to Sady from $20 to $30.

Also in the summer of 1986, Libera met appellant Francis Sablone, an attorney. Sablone and Libera used the same stock broker, Ralph Presutti, at Advest, Inc. Sablone learned of Libera's early acquisition of *Business Week* and of his trading on information in the "Inside Wall Street" column. Sablone then also began trading regularly on Thursday mornings in *Business Week* securities, receiving the information either from Libera or Presutti. Sablone made fifty-seven trades at a profit of approximately $36,000. Dillon testified that in early 1987 he informed Sablone that the employees were not permitted to remove magazines from the plant and that Sady was being paid $30 per copy for the magazine.

In the spring of 1987, Sablone took his trading business to Nicholas Bokron of E.F. Hutton. He told Bokron that some of his trades were based on *Business Week* information. In late September, Bokron was informed by his superiors that trading in securities based on an early acquisition of *Business Week* raised serious questions of illegal insider trading. Bokron knew that Sablone had recently placed such a trade. He contacted Sablone, advised him of his superior's concerns, and told him that he would not accept any more trades based on *Business Week* information. On five subsequent occasions Sablone traded in securities based on *Business Week* information with other brokerage houses.

DISCUSSION

Appellants' convictions are based on the so-called misappropriation theory arising out of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).[2]

---

[2] Section 10(b) provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the

> mails, or of any facility of any national securities exchange -
>
> . . .
>
> (b) To use or employ. . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j(b) (1988). Pursuant to this section, the SEC has promulgated 17 C.F.R. 240.10b-5 (1992), which provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> . . .
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

Sitting *in banc*, we recently restated that theory: "[O]ne who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b-5." *United States v. Chestman*, 947 F.2d 551,564 (2d Cir. 1991) (*in banc*) (citation omitted), *cert. denied*, 112 S. Ct. 1759 (1992); *see also id.* at 576 ("[L]ower courts have added to the *Dirks* [*v. SEC*, 463 U.S. 646 (1983),] breach of duty doctrine a misappropriation of information doctrine, which prohibits trading in securities based on material, nonpublic information acquired in violation of a duty to any owner of such information, whether or not the owner is the corporation whose shares are traded.") (Winter, J., concurring and dissenting opinion). We have found the requisite fiduciary duty in the employer/employee context. *See United States v. Carpenter*, 791 F.2d 1024, 1028 (2d Cir. 1986), *aff'd*, 484 U.S. 19(1987); *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *aff'd after*

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in connection with the purchase or sale of any security.

remand, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983); *SEC v. Materia*, 745 F.2d 197,201 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985). We have also noted that "the misappropriation theory does not require that the buyer or seller of securities be defrauded." *Chestman*, 947 F.2d at 566. Rather, "the predicate act of fraud may be perpetrated on the source of the nonpublic information, even though the source may be unaffiliated with the buyer or seller of securities." *Id*. This fraud has been analogized to embezzlement, see *Carpenter*, 791 F.2d at 1033 n. 11, and may simply be thought of as the misuse, by trading, of stolen information. See *Chestman*, 947 F.2d at 578 (Winter, J., concurring and dissenting opinion).

A. *The Tipper's Knowledge of the Tippee's Intent to Trade*

Sablone first argues that an essential element of Section 10(b) liability is that tippers must specifically know that their breach of a fiduciary obligation in misappropriating information will lead to trading on the information. This

element is not required by our prior cases,[3] and we decline to add it here.

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[3] Sablone bases his argument largely on language in *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985). In *Reed*, the court considered defendant's motion pursuant to Rule 12(b) of the Fed. R. Crim. P. to dismiss his indictment on four counts, count one of which charged securities fraud. *Id.* at 688-89. The language relied upon by Sablone is not the holding of the district court but rather that court's restatement of Reed's argument in support of his motion to dismiss the indictment. The court stated that as Reed's "argument proceeds, an essential element of tippee liability under Rule 10b-5 is proof that the tipping insider disclosed the confidential information with the knowledge or expectation that the tippee would trade on the information, and thus, with the intent to defraud the securities holders of the insider's company." *Id.* at 694. The court dismissed the argument noting that the indictment did not allege the existence of such a state of mind of the tipper, Reed's father, and that the government had formally acknowledged that it would not seek to establish such an intent because it was not necessary to their case under a misappropriation theory. *See id.* at 693-94 n.15. The court thus held that, without this element, count one alleged sufficient facts that a jury could find that defendant committed securities fraud under 15 U.S.C. § 78j(b). *Id.* at 737.

In *Chestman*, we noted that the misappropriation theory requires the establishment of two elements: (i) a breach by the tipper of a duty owed to the owner of the nonpublic information; and (ii) the tippee's knowledge that the tipper had breached the duty. *See Chestman*, 947 F.2d at 570. We believe these two elements, without more, are sufficient for tippee liability. *See Dirks*, 463 U.S. at 659. The tipper's knowledge that he or she was breaching a duty to the owner of confidential information suffices to establish the tipper's expectation that the breach will lead to some kind of a misuse of the information. This is so because it may be presumed that the tippee's interest in the information is, in contemporary jargon, not for nothing. To allow a tippee to escape liability solely because the government cannot prove to a jury's satisfaction that the tipper knew exactly what misuse would result from the tipper's wrongdoing would not fulfill the purpose of the misappropriation theory, which is to protect property rights in information. *See Chestman*, 947 F.2d at 576-78 (Winter, J., concurring and dissenting opinion). Indeed, such a

requirement would serve no purpose other than to create a loophole for such misuse.

B. *Sufficiency of Evidence*

Appellants also argue that there was insufficient evidence: (i) that a fiduciary duty of confidentiality existed because the information was already public; (ii) that, even if the information was nonpublic, the Donnelley employees willfully breached a fiduciary duty owed to Donnelley; and (iii) that, even if the information was nonpublic and the tippers breached a fiduciary duty, appellants knew or were reckless in not knowing that they were trading on misappropriated nonpublic information.

We note the familiar principle that a defendant who challenges the sufficiency of the evidence underlying a conviction bears a "very heavy burden." *United States v. Rivalta*, 892 F.2d 223,227 (2d Cir. 1989). That burden is met only if, after viewing the evidence in the light most favorable to the prosecution, no rational trier of fact could have found the essential elements of the crime. *United States v. Tejada*, 956 F.2d 1256, 1265 (2d Cir. 1992)

(stating the converse). In finding these essential elements, the jury may base its verdict on inferences from circumstantial evidence. *See e.g., United States v. Padilla*, 961 F.2d 322, 324 (2d Cir.), *cert. denied*, 113 S. Ct. 138 (1992). Finally, "in reviewing a challenge to the sufficiency of evidence, 'we must credit every inference that could have been drawn in the government's favor.' "*Tejada*, 956 F.2d at 1265 (*quoting United States v. Labat*, 905 F.2d 18,22 (2d Cir. 1990)).

1. *There was sufficient evidence that the information was material and nonpublic*

It is, of course, axiomatic that trading on public information does not violate Section 10(b) and appellants argue that the *Business Week* information was public before they traded. They argue that the information was released by McGraw-Hill on Thursday prior to the 5:00 p.m. deadline. We disagree. First, we note that the earliest time of release to the press argued by appellants is noon, Thursday. However, many of their trades were before that hour. Second, their description of the timing of publication is wrong. The magazines were sent to McGraw-Hill's press

manager at noon, packaged in the afternoon, and distributed by messenger in time for "the nightly news." There was a message on the press package prohibiting release of the information until after 5:00 pm. The jury could thus easily conclude that there was no public announcement of the information before 5:00 p.m.

Appellants also argue that the information was public because the stocks mentioned in the "Inside Wall Street column began increasing in volume and price on Wednesday. We agree that information may be considered public for Section 10(b) purposes even though there has been no public announcement and only a small number of people know of it. The issue is not the number of people who possess it but whether their trading has caused the information to be fully impounded into the price of the particular stock. Once the information is fully impounded in price, such information can no longer be misused by trading because no further profit can be made. However, trading on stolen information that is not fully impounded in price is a misuse of such information whether or not others are also trading on it. Otherwise, only the first misuse of stolen information would

be illegal even though subsequent trades involved indistinguishable misconduct. Because appellants concede that the increase in trading volume and price of the securities in question continued after the release of the magazine to the general public, the jury was correct in finding that the information was not fully impounded in the price at the time of appellants' trades and was not public for purposes of Section 10(b) prior to the magazine's release.

2. *There was sufficient evidence that the employees willfully breached a fiduciary duty to McGraw-Hill and Donnelley*

Appellants also assert an insufficiency claim as to whether the Donnelley employees who delivered the magazine to appellants willfully breached a fiduciary duty to McGraw-Hill and Donnelley. The claim is entirely baseless. As noted, McGraw-Hill had expressly informed Donnelley of its confidentiality policy. Donnelley had adopted this policy and conveyed it to its employees at orientation, in employee manuals, by posters next to exits, and through word of mouth.

James Roddy, Human Resources Manager for the Old Saybrook plant, stated that outsiders had attempted to acquire magazines from the plant, had been rebuffed, and had been reported to McGraw-Hill. McGraw-Hill periodically tested its printers by attempting to acquire early copies of *Business Week*. Jack Dierdorff, the Managing Editor of *Business Week*. testified that when McGraw-Hill suspected a leak of the "Inside Wall Street" column in 1987, it investigated its security procedures. It directed Donnelley to review their security procedures, and as a result, the Old Saybrook plant enhanced those measures. Finally, the witness/employees who delivered early copies of *Business Week* to appellants testified that they were aware of the policy and concealed the magazine to get it out of the plant.

3. *There was sufficient evidence that appellants knew that the employees had breached a fiduciary duty to their employer*

a. *Libera*

Libera argues that it was unreasonable as a matter of law to infer knowledge on his part that the contents of *Business Week* were confidential. A rational jury could find,

however, that his knowledge of the confidentiality of *Business Week* and the consequential breach of the employees' fiduciary duty was a reasonable inference from the evidence.

Dillon testified that he explicitly told Libera that the employees were forbidden from taking magazines out of the plant. Moreover, Libera's conduct was compelling evidence of his consciousness of wrongdoing. He paid Sady amounts well in excess of the newsstand price for the magazine and originally concealed from his broker the manner in which he acquired the magazines. Revealingly, when Libera discussed the Securities and Exchange Commission investigation with his broker Presutti, he disclosed for the first time what was paid for the magazine, stating "I hope they don't find out that Dillon was paying $30 a copy." This evidence easily justified the jury's inferring that Libera knew that the employees were breaching a fiduciary duty to McGraw-Hill.

b. *Sablone*

Dillon testified that he met with Sablone and told him that the employees were not allowed to take the magazine out of the plant and that the employees were receiving

payment upon delivery of the magazine. Sablone was warned by his broker Bokron about trading on *Business Week* information. Sablone ignored these warnings and, when Bokron refused his orders, he traded with other brokerage houses.[4]

Sablone argues that Dillon did not tell him that the employees were forbidden from taking the magazine out of the plant. He relies on the testimony of John Isleib, Libera's cousin, who testified that he was present at the meeting at which Dillon supposedly told Sablone of the prohibition and that no such discussion took place. Sablone testified in a deposition before the SEC, however, that he had met Dillon on two occasions. Moreover, the jury obviously believed Dillon and not Libera, and Sablone is driven to argue that Dillon's testimony is incredible as a matter of law. There is no basis for such a ruling.

---

[4] Sablone testified that he consulted with his brokers about whether his activities were legal and claimed to have relied on their opinion that his use of *Business Week* information was legal. However, his brokers denied any such conversation, and the jury was free to credit their denial.

CONCLUSION

Appellants' arguments that a conspiracy to commit securities fraud did not exist is so meritless as not to warrant discussion. In addition, appellants' activities clearly involved a scheme that used the mails and instrumentalities of interstate commerce. *See Carpenter v. United States*, 484 U.S. 19,28 (1987).

For the reasons stated above, the convictions are affirmed.

UNITED STATES COURT OF APPEALS
FOR THE
SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 12 day of May
on thousand nine hundred and three *[sic]*

UNITED STATES OF AMERICA,

Appellee,

-v.-

BENJAMIN B. LIBERA
and FRANCIS R. SABLONE, JR.,

Defendants-Appellants.

DOCKET NUMBERS: 91-1741, 91-1750

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by **Appellant FRANCIS R. SABLONE, JR.,**

Upon consideration by the panel that decided the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT
ELAINE B. GOLDSMITH, Clerk

By: _____
Carolyn Clark Campbell
Chief Deputy Clerk

STATUTORY PROVISIONS AND RULES

1. Section 78j of title 15 of the United States Code provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --
>
> (a) To effect a sort sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or

contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

2. Section 240.10b-5 of title 17 of the Code of Federal Regulations provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Supreme Court, U.S.
FILED
OCT 25 1993
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(2)

No. 93-215

In the Supreme Court of the United States

OCTOBER TERM, 1993

FRANCIS R. SABLONE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioner's trading in securities while in possession of material non-public information that was misappropriated from a financial publication violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

2. Whether information that has not been disseminated to the investing public is rendered public when there has been a limited distribution of the information immediately before its official release time and there may have been some trading on the information before its official release.

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In the Supreme Court of the United States

OCTOBER TERM, 1993

No. 93-215

FRANCIS R. SABLONE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals, Pet. App. 2a-25a, is reported at 989 F.2d 596.

JURISDICTION

The judgment of the court of appeals was entered on March 22, 1993. A petition for rehearing was denied on May 12, 1993. Pet. App. 26a-27a. The petition for a writ of certiorari was filed on August 10, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the District of Connecticut, petitioner was convicted on one count of conspiracy, in violation of 18 U.S.C. 371, and 59 counts of securities fraud, in violation of Sections 10(b) and 32 of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b) and 78ff, and Rule 10b-5, 17 C.F.R. 240.10b-5. Pet. App. 5a. Petitioner was sentenced to six months' home confinement, three years' probation, and 400 hours of community service, and was fined $5,000. C.A. App. 37-38.

1. Petitioner traded in securities while in possession of wrongfully obtained, non-public information contained in pre-publication copies of articles in *Business Week* magazine. R.R. Donnelley & Sons Co. (Donnelley) was the printer of *Business Week*, a weekly publication owned by McGraw-Hill, Inc. Each week, the printing of *Business Week* began late on Wednesday evening and continued into Thursday. Since at least 1981, both McGraw-Hill and Donnelley followed a policy of keeping the contents of the weekly issue of *Business Week* confidential until 5:00 p.m. on Thursday. Pet. App. 5a-6a.

Donnelley employees knew that company rules forbade the removal of magazines from the plant. At orientation, new employees were advised of the need to maintain the confidentiality of customer materials. Employees also received a Donnelley handbook advising them of the confidentiality policy. The handbook forbade even the discussion of the contents of magazines, much less their removal. Employee manuals placed at several locations throughout the plant contained similar warnings. In addition, a poster was

placed in the employee entrance hallway stating that all customer materials were to be treated with absolute confidence. Pet. App. 6a-8a.

In early 1986, William Dillon, whose wife was a Donnelley employee, obtained copies from her of *Business Week* on Friday mornings (by which time it was public) when she came home after her four-to-midnight Thursday shift. Dillon began tracking the stocks of companies analyzed in Gene Marcial's "Inside Wall Street," a regular *Business Week* column. The column recommended investing in various companies based on Marcial's consultation with analysts and other sources. Dillon observed that trades in favorably mentioned securities often increased in volume and price, beginning on the Wednesday before publication and continuing through the next Monday. Pet. App. 9a.

Recognizing that it would be valuable to receive *Business Week* earlier than Friday morning, Dillon made arrangements with another Donnelley employee to obtain a copy of the magazine, or simply a copy of the "Inside Wall Street" column, at 9:00 a.m. on Thursday mornings. When that employee changed his shift and could no longer provide copies, Dillon approached another Donnelley employee, William Sady, who agreed to bring the magazine out at the end of his midnight-to-eight Thursday morning shift. Sady delivered the magazine to Dillon over a two-year period at an initial price of $20 per copy. Pet. App. 9a-10a.

In the summer of 1986, Dillon approached his friend Brad Libera and told him that early investment in securities named in the "Inside Wall Street" column was a profitable strategy. Libera, who initially

accompanied Dillon to the magazine deliveries and later began making the pick-ups alone, executed a total of 64 Thursday trades in such stocks, resulting in a profit of approximately $95,000. Pet. App. 10a-11a.

In the summer of 1986, petitioner, who is an attorney, met Libera. He and Libera used the same stock broker, Ralph Presutti, at Advest, Inc. Petitioner learned of Libera's early acquisition of copies of *Business Week* and of his trading on information in the "Inside Wall Street" column. Petitioner began receiving information from either Libera or Presutti and began trading regularly on Thursday mornings in securities discussed in the column. Dillon testified that in early 1987 he informed petitioner that Donnelley employees were not permitted to remove magazines from the plant and that Sady was being paid $30 per copy for the magazine. Petitioner made 57 trades for a profit of approximately $36,000. Pet. App. 11a.

In the spring of 1987, petitioner took his trading business to Nicholas Bokron of E.F. Hutton & Co. He told Bokron that some of his trades were based on *Business Week* information. In late September, Bokron was informed by his superiors that trading in securities based on early acquisition of *Business Week* raised serious questions of illegal insider trading. Bokron contacted petitioner, advised him of his superior's concerns, and told him that he would not accept any more trades based on *Business Week* information. On five subsequent occasions petitioner traded in securities based on *Business Week* information with other brokerage houses. Pet. App. 12a.

2. The court of appeals affirmed petitioner's conviction. Pet. App. 2a-25a. The court observed that petitioner's prosecution was based on the "misappro-

priation theory" of securities fraud. *Id.* at 12a. It described that theory as holding that "[o]ne who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b-5." *Id.* at 14a, quoting *United States* v. *Chestman*, 947 F.2d 551, 564 (2d Cir. 1991) (en banc), cert. denied, 112 S. Ct. 1759 (1992). The court explained that the misappropriation theory "does not require that the buyer or seller of securities be defrauded." Pet. App. 15a, quoting *Chestman*, 947 F.2d at 566. Rather, "the predicate act of fraud may be perpetrated on the source of the nonpublic information, even though the source may be unaffiliated with the buyer or seller." Pet. App. 15a, quoting *Chestman*, 947 F.2d at 566.

The court of appeals rejected petitioner's argument that he could not be held liable as a tippee of the information unless his tipper specifically knew that the tip would lead to trading on the information. The court held that such proof "is not required" by the case law and "would serve no purpose other than to create a loophole" for misuse of wrongfully obtained information. Pet. App. 15a-18a.

The court of appeals also held that the evidence was sufficient to establish that the information obtained by petitioner was non-public. Pet. App. 19a. The court found that there was no public release of the information before 5:00 p.m. on Thursday and rejected the argument that even though the information had not been publicly announced, it was public because trades in the stocks mentioned in the "Inside Wall Street" column began increasing in volume and price on Wednesday. The court stated that "trading on stolen information that is not fully impounded in price

is a misuse of such information whether or not others are also trading on it." *Id.* at 20a. "Because [petitioner] concede[s] that the increase in volume and price of the securities in question continued after the release of the magazine to the general public," the court found that "the information was not fully impounded in the price at the time of [petitioner's] trades" and thus was not public. *Id.* at 21a.

Finally, the court held that the evidence was sufficient to establish that petitioner knew that the information he received was obtained in breach of a duty. Pet. App. 22a-24a.

ARGUMENT

1. Petitioner contends (Pet. 12, 16-17) that the misappropriation theory of liability under the securities laws does not apply in this case because the only victim of the fraud "was the magazine publisher, McGraw-Hill, which undeniably lacked any interest in the purchase [or] sale * * * of the securities traded." Pet. 13. That contention is unfounded.

Under the misappropriation theory of liability, the fraudulent misappropriation of material non-public information in connection with the purchase or sale of securities violates Section 10(b) of the Exchange Act and Rule 10b-5. The misappropriation theory has been adopted by every court of appeals that has considered it. See *SEC* v. *Cherif*, 933 F.2d 403 (7th Cir. 1991), cert. denied, 112 S. Ct. 966 (1992); *SEC* v. *Clark*, 915 F.2d 439 (9th Cir. 1990); *United States* v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986), aff'd in relevant part by an equally divided Court, 484 U.S. 19 (1987); *SEC* v. *Materia*, 745 F.2d 197 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985); *United States* v. *Newman*, 664 F.2d 12 (1981), aff'd after remand, 722 F.2d 729 (2d Cir.)

(Table), cert. denied, 464 U.S. 863 (1983). See also *Rothberg* v. *Rosenbloom*, 771 F.2d 818, 825 (3d Cir. 1985) (Higginbotham, J., concurring).

Petitioner does not challenge the validity of the misappropriation theory in general, but seeks review of the theory only as applied to cases in which the "victim of the alleged fraud" is not a market participant. Pet. 12. Section 10(b) and Rule 10b-5 are not restricted to frauds on a market participant. Those provisions make it unlawful to engage in "any act * * * which operates or would operate as a fraud or deceit upon any person," where that fraud occurs "in connection with" a securities transaction. 15 U.S.C. 78j(b) and Rule 10b-5, 17 C.F.R. 240.10b-5(c). This Court has consistently construed those provisions broadly, noting that Section 10(b) is "a 'catchall' clause to enable the Commission 'to deal with new manipulative [or cunning] devices,'" *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976) (brackets added by Court), and that the statute and rule "are obviously meant to be inclusive." *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972).

Petitioner's conduct falls within the scope of those provisions. There is no dispute that petitioner engaged in a fraud by deceitfully depriving McGraw-Hill of the exclusive use of confidential information. See *Carpenter* v. *United States*, 484 U.S. 19, 27-28 (1987) (affirming mail and wire fraud convictions for trading while in possession of information misappropriated from newspaper). The sole question is whether that fraud was "in connection with" the purchase or sale of securities, since McGraw-Hill was not itself trading in the securities involved.

This Court has construed the "in connection with" requirement expansively. See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971) (applies to "deceptive practices touching" a securities transaction); see also *United States* v. *Naftalin*, 441 U.S. 768 (1979) (in government enforcement action the victim of securities fraud need not be a purchaser or seller, or even an investor). That requirement is satisfied here. The information that was misappropriated was *Business Week*'s advice concerning securities. The "sole purpose" for misappropriating that information was to use it to trade in securities. See *Newman*, 664 F.2d at 18; *Materia*, 745 F.2d at 203. The fraud was integrally related to the misappropriator's securities transactions; indeed, to him the stolen information "ha[d] no value whatsoever except 'in connection with' his subsequent purchase of securities."[1] *Materia*, 745 F.2d at 203.

Petitioner errs in contending (Pet. 16-17) that McGraw-Hill "was not defrauded of anything which was securities-related, which would invoke the protection of Rule 10b-5." *Business Week*'s information was inherently "securities-related"; it consisted of discussions and recommendations about publicly

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[1] Petitioner contends (Pet. 17 & n.3) that the government's theory in this case "would reach any type of property theft even if the property was absolutely unrelated to securities," and gives, as an example, one who steals money and then uses it to buy securities. Courts have upheld liability under the misappropriation theory, however, only when the theft in question involves information, and they have required that the information be material to a decision to buy or sell securities. Property that is "absolutely unrelated to securities" does not meet the latter criterion, and petitioner's hypothetical meets neither criterion.

traded stocks, and the primary value of that information flowed from its utility in making investment decisions. Maintaining the confidentiality of that information before publication protected *Business Week*'s reputation for integrity.[2] See *Dirks* v. *SEC*, 463 U.S. 646, 658-659 (1983) (noting the importance of securities analysts to the efficient functioning of capital markets). It also preserved the value of the information to investors who might wish to trade on the basis of it. Investors who rely on *Business Week*'s information assume that it has not previously been the subject of trading by others. Petitioner's conduct undermined *Business Week*'s ability to provide investors with such "fresh" information. Accordingly, application of the misappropriation theory in this case furthers the purpose of the securities laws to protect investors.[3]

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[2] Petitioner is incorrect in asserting (Pet. 13) that "the only alleged harm from the so-called fraudulent scheme was the deprivation of McGraw-Hill's intangible right to keep secret the information contained in the magazine or to release the information at its whim, accompanied by whatever loss of reputation McGraw-Hill purportedly suffered by the revelation of the fact that it had difficulty enforcing its own corporate policies." Keeping the information confidential before publication was not a matter of "whim" but of business necessity. And, applying the misappropriation theory in this case does not entail the use of the federal securities laws "to enforce internal corporate policies." Pet. 14. Confidential business information has long been considered property under common law concepts, and criminal and civil provisions protect that property right in a variety of contexts. *Carpenter* v. *United States*, 484 U.S. at 27-28.

[3] There is no merit to petitioner's contention (Pet. 15-16) that the court of appeals' decision resurrects the "parity of information" theory of liability rejected by this Court in

While petitioner suggests (Pet. 28) that the decision in this case has a "wide-ranging * * * effect," there is no conflict in the lower courts with respect to the issue in this case; it has arisen in only this and two other cases. *United States* v. *Carpenter*, 791 F.2d 1024 (2d Cir. 1986) (theft of information from the *Wall Street Journal*), aff'd in relevant part by an equally divided court, 484 U.S. 19 (1987); *SEC* v. *Callahan*, 1990 Fed. Sec. L. Rep. (CCH) ¶ 95,609 (C.D. Cal. July 12, 1990) (theft of *Business Week* information). And, in view of this Court's holding in *Carpenter* that schemes like petitioner's violate the mail and wire fraud statutes, the imposition of criminal liability in this context cannot have come as a surprise to petitioner.

Moreover, since the recognition of the misappropriation theory by the courts, Congress has provided remedies for insider trading violations based on the misappropriation theory, and in no instance has Congress drawn a distinction between fraud on market participants and fraud on non-market partici-

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Chiarella v. *United States*, 445 U.S. 222 (1980). The "parity of information" theory proscribed "[t]he use by anyone of material information not generally available." *Id.* at 232. The misappropriation theory does not impose liability because the trader has information unavailable to others. It imposes liability because information is acquired through a fraud on the source of the information. *Chiarella* left open the question whether liability under Rule 10b-5 could be founded on the misappropriation theory (the theory had not been presented to the jury in that case, 445 U.S. at 235-236), and all four Justices who spoke to the issue suggested that liability for misappropriation would be valid. See *id.* at 239 (Burger, C.J., dissenting); *id.* at 238 (Brennan, J., concurring in the judgment); *id.* at 245 (Blackmun, J., joined by Marshall, J., dissenting).

pants. See 15 U.S.C. 78u-1 (authorizing the Commission to seek penalties for insider trading); 15 U.S.C. 78t-1 (providing contemporaneous traders in the market with an express cause of action for damages against persons who engage in violations by purchasing or selling securities while in possession of material, non-public information). Indeed, the legislative history of the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, indicates approval of the misappropriation theory as applied in *Carpenter* where, as in this case, the victim of the fraud was a financial publication.[4]

2. Petitioner contends (Pet. 18-23) that he committed no fraud because the contents of *Business Week*'s "Inside Wall Street" column were already public "as a matter of law" (Pet. 18-19) at the time he traded. He also contends (Pet. 23-27) that the court of appeals applied an incorrect test in rejecting his claim that pre-publication trading rendered the information no longer confidential. The court of appeals correctly held that the evidence was sufficient to establish that the information was non-public at the time of petitioner's trades.

a. Petitioner argues that the information was public because the magazine's publisher "voluntarily released hundreds of copies of *Business Week* on Thursday afternoons to members of the media * * * despite its own policy that the magazine not be distributed until 5:00 p.m." (Pet. 18), and those mem-

[4] After discussing the misappropriation theory generally and the *Carpenter* case specifically, the House Committee Report stated that "this type of security fraud should be encompassed within Section 10(b) and Rule 10b-5." H.R. Rep. No. 910, 100th Cong., 2d Sess. 10 (1988).

bers of the press had no obligation to keep the information confidential or to refrain from trading on the basis of it. Pet. 19-20.

The court of appeals correctly held that distribution of the magazine to other press organizations did not constitute public dissemination of its contents. As the court explained, the magazines were "sent to McGraw-Hill's press manager at noon, packaged in the afternoon, and distributed by messenger in time for 'the nightly news.' There was a message on the press package prohibiting release of the information until after 5:00 p.m. The jury could thus easily conclude that there was no public announcement of the information before 5:00 p.m." on Thursday. Pet. App. 19a-20a.

The evidence showed that petitioner was "trading regularly on Thursday mornings," Pet. App. 11a, before *any* distribution was made to the press. Even if petitioner made some trades after the magazine was given to the press, however, the information was not publicly disseminated at that point. Under established law, petitioner was barred from trading until the non-public information "ha[d] been effectively disclosed in a manner sufficient to insure its availability to the investing public." *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 854 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).[5] Even if the press

[5] See *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973) ("Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group."); *Billard* v. *Rockwell Int'l Corp.*, 683 F.2d 51, 55 (2d Cir. 1982) (*Texas Gulf Sulphur* held that "Rule 10b-5

organizations had time to disclose the magazine's contents, they did not do so, likely because they were under the constraint of the publisher's directive not to make disclosure before 5:00 p.m.[6] And petitioner does not claim that dissemination to press outlets, who kept the information under wraps, itself constituted dissemination "to the investing public."

Petitioner also suggests (Pet. 21-22) that the information was public because there was increased trading activity in the stocks at issue in the two days before release of the magazine. The fact that others may have traded on non-public information does not mean that the information necessarily had become public, however. As the court of appeals noted, petitioner's rule would grant a safe haven for those who improperly trade while in possession of confidential material, provided only that some other person had already so traded. Pet. App. 20a-21a.

b. Petitioner also attacks (Pet. 23-27) the approach taken by the court of appeals in its rejection of his

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prohibited trading by insiders possessing confidential information which had been released but had not appeared on the Dow Jones broad tape and thus was not yet in the public domain"); *SEC* v. *MacDonald*, 568 F. Supp. 111, 112-113 (D.R.I. 1983) (insider trader's disgorgement obligation calculated based on price of stock "a reasonable time after public dissemination of the insider information"), aff'd, 725 F.2d 9 (1st Cir. 1984).

[6] Petitioner argues (Pet. 20) that the directive imposed no fiduciary or other legal restraint on disclosure by the press. The issue, however, is not whether the press had the theoretical right to make disclosure; it is whether disclosure to the press rendered the information public for purposes of Rule 10b-5. The directive acted as a powerful practical constraint, and there was no showing that the press made actual disclosure before 5:00 p.m.

claim that pre-publication trading by other persons rendered the *Business Week* information public. The court of appeals stated that information could become public, "even though there has been no public announcement," when trading is so widespread that the information has been fully "impounded" into the price of the security; according to the court, "such information can no longer be misused by trading because no further profit can be made." Pet. App. 20a. The court found, however, that petitioner failed to establish that the information in his possession was "fully impounded in the price" at the time of his trades. *Id.* at 21a.

Petitioner argues (Pet. 24) that the court added a new element to the law of insider trading by requiring, not only that information be publicly announced, but also that it be "fully impounded" in the price of a security to be public. He suggests (Pet. 25) that using "impoundment" as a proxy for the "'public nature' of information" leads to irrational results, and he complains (Pet. 26-27) that he did not have an adequate opportunity to address that issue at trial.

The court of appeals did not add a new element of "impoundment" to the law of insider trading. The court concluded that even when there is no public announcement, information may nonetheless be considered to be public when it is fully reflected in the stock price. Pet. App. 20a. The court did not suggest that information that is made public by an announcement must *also* be made public by impoundment. Accordingly, petitioner's hypothetical situation (Pet. 25) in which liability would attach when information has been publicly released but is not fully reflected in

the stock price does not arise under the court of appeals' holding.[7]

Nor was petitioner denied a chance to put on evidence addressing the issue of impoundment. Because a major portion of petitioner's defense at trial was that the *Business Week* information was made public before his trading, he had every incentive to put on all evidence concerning the price behavior of the stocks. He likely did not do so because, as he conceded in the court of appeals, "the securities were sold immediately [by Dillon on Monday morning] to

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[7] While the court of appeals correctly found that there was no public disclosure of the *Business Week* information at issue in this case before petitioner's trading, we disagree with the court of appeals' statement that information may become "public" by being impounded into the price of a security. It is true that "most publicly available information is reflected in market price," *Basic Inc.* v. *Levinson*, 485 U.S. 224, 247 (1988), but it does not follow that all information that is reflected in market price has become public. Undisclosed information that is impounded into the price of the security has become "known" to the public only in an indirect, economic sense, which is not the equivalent of publicly announcing the information. The owner of the information continues to have the right to bar its use, and trading in such circumstances is just as much a violation of that right as at any earlier time. If, by the fortuity of "impoundment," the misappropriator does not profit from his trading, it would not exonerate him from fraud or render civil or criminal remedies inappropriate. The court of appeals' statement that disclosure can occur through impoundment, however, does not warrant review here. The court found that disclosure did not occur by that means in this case and that whatever dissemination of the *Business Week* information occurred prior to petitioner's trading did not amount to public disclosure. That conclusion is correct, and review of the "impoundment" theory, if warranted, can await a case in which it affects the outcome.

capitalize on the release of the information." Pet. C.A. Br. 46 & n.16. If the information had been fully impounded by the time of petitioner's purchases, its release would have had no effect on the market and there would have been no price movement on which to "capitalize."

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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In The
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FRANCIS R. SABLONE, JR.,
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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITIONER'S REPLY

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QUESTIONS PRESENTED FOR REVIEW

1. Does SEC Rule 10b-5 impose criminal sanctions for the "misappropriation" of information contained in a weekly periodical, when the only victim of the alleged fraud is the publisher of the periodical?

2. Can information contained in a weekly periodical be considered "non-public" and "confidential" for purposes of Rule 10b-5 when the information is voluntarily disseminated by the publisher prior to the "official" release time of the magazine and where the market already reflects trading on the information?

3. Does Rule 10b-5 prohibit trading on information until such time as the information has been "impounded" into the market price of the security involved?

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PETITIONER'S REPLY

ARGUMENT

A. RULE 10b-5 SHOULD NOT BE EXTENDED TO IMPOSE CRIMINAL SANCTIONS FOR FRAUD ON NON-MARKET PARTICIPANTS.

In his brief in opposition to the petitioner's writ, the Solicitor General fails to acknowledge that this case differs from almost all other actions involving the "misappropriation" theory of securities fraud first enunciated by the Second Circuit Court of Appeals in *United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983). With the exception of *Carpenter v. United States*, 484 U.S. 19 (1987), in those actions in which the defendant was charged with misappropriating material, non-public and confidential information and using that information to trade in securities, the owner of the information had an undeniable interest in the actual purchase or sale of the traded security. *See, e.g., SEC v. Cherif*, 933 F.2d 403 (7th Cir. 1991), *cert. denied*, 112 S. Ct. 966 (1992); *SEC v. Clark*, 915 F.2d

439 (9th Cir. 1990); *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *Newman*, 664 F.2d 12.[1]

Here, as in *Carpenter*, however, the owner of the allegedly misappropriated information had no intention of utilizing that information to maximize profit or limit loss by using the information in a securities transaction; rather, the value of the information lay solely in its possession and in the privilege of deciding when to release it. There is no claim that the Wall Street Journal in *Carpenter* or McGraw-Hill in this action suffered any loss by virtue of the actual trading which occurred after the misappropriation. To the contrary, any harm

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[1] The Solicitor General chides the petitioner for failing to challenge the creation of the misappropriation doctrine, the validity of which has never been approved by this Court. Brief in Opposition (hereinafter "Opp.") at 7. The petitioner responds that it is unnecessary for this Court to perform that global evaluation where the application of that doctrine in this case is so clearly misguided. Of course, it remains within this Court's power to perform that review, despite the absence of urging by the petitioner.

suffered by these entities came about from the loss of control over the information: whatever use was made of the information after that loss was irrelevant to their interests.[2] This is in sharp distinction to those who are victimized by virtue of their participation in the stock market, injuries which inarguably fall within the scope of federal securities laws.

It is this crucial and obvious difference between victims which distinguishes this matter from the cases relied on by the Solicitor General (Opp. at 6) and which compels review of the petitioner's conviction by this Court. The Solicitor General's reluctance to address the significance of whether the owner of the misappropriated information is a non-market participant can be fairly

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[2] In addition, because that loss has been interpreted to be nothing more than a loss of reputation, which is actionable at common law, there would be no purpose in providing relief under federal securities laws to these "victims" of misappropriation. *See Carpenter v. United States*, 791 F.2d 1024, 1037 (2d Cir. 1986)(Miner, J., dissenting).

interpreted as an inability on his part to justify such an unreasonable expansion of section 10(b) and Rule 10b-5.[3] This Court should accept review of this matter in order to properly restrict the application of Rule 10b-5 to schemes to defraud market participants, leaving any other causes of action to the control of the common law.

B. UPON RELEASE TO THE MEDIA, THE CONTENTS OF *BUSINESSWEEK* WERE NO LONGER "NON-PUBLIC" NOR "CONFIDENTIAL" WITHIN THE MEANING OF RULE 10b-5.

Contrary to the Solicitor General's report (Opp. at 13), the petitioner does claim that dissemination of *BusinessWeek* to members of the media constitutes a

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[3] In arguing that the type of victim is irrelevant, the Solicitor General reports that Congress has never drawn a distinction between fraud perpetrated on market participants versus non-market participants. (Opp. at 10). The Solicitor General's own citation to authority for that proposition reveals the inaccuracy of his claim: Although Congress has authorized a private cause of action for those who trade "contemporaneously" with a defrauder; 15 U.S.C. § 78t-1; no such private cause of action has been expressly created for those who suffered a loss which is unrelated to trading.

release of the contents to the public. As set forth in the petition (Pet. at 18-21), McGraw-Hill's decision to distribute hundreds of copies of the magazine prior to its own 5:00 p.m. embargo deprives it of the right to later claim that any information contained therein remained both "confidential" and "non-public" until that arbitrary deadline. The Solicitor General's contention that the confidentiality of the information was preserved by the rules of professional courtesy[4] cannot alter the fact that McGraw-Hill knowingly and voluntarily furnished copies of the periodical to members of the media, whose very purpose in life is to disseminate information and who had absolutely no duty, legally or ethically, to refrain from doing so. *See, e.g., United States v.*

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[4] Even if professional courtesy was sufficient to guarantee that the information would be kept "under wraps," (Opp. at 13), the only information restricted by McGraw-Hill in its distribution was that contained in the press release, which did not concern the contents of the "Inside Wall Street" column. At no time was the media instructed to resist reading the magazine itself or, obviously, to refrain from trading on any information contained therein.

Chestman, 947 F.2d 551, 567 (2d Cir. 1991)(en banc), *cert. denied*, 112 S. Ct. 1759 (1992)("[A] fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information.").

To accept the Solicitor General's view of the harmlessness of this mass distribution, this Court would have to first retreat from its statement in *Dirks* that for information to be confidential, there must be an expectation of privacy. *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983). Second, this Court would also have to adopt differing levels of publication; i.e., that widespread distribution of information to one segment of the populace (here, the media) does not constitute publication for purposes of the securities laws. Such a distinction would be illogical and ill-advised.

C. WHETHER INFORMATION HAS BEEN "IMPOUNDED" INTO THE PRICE OF A SECURITY IS IRRELEVANT TO THE APPLICATION OF RULE 10b-5.

Both the Solicitor General and the petitioner agree that the Court of Appeals erred by introducing an

"impoundment" factor into the calculus used to determine whether information is public for purposes of Rule 10b-5.[5] (Opp. at 15 n.7). While the Solicitor General counsels that consideration of this departure from established law can "await" review in some future case, however, the petitioner contends that such a delay would not serve the interests of justice.

First, the Solicitor General is incorrect in implying that consideration of this new element does not affect the outcome of this particular matter. As can be seen from the Court of Appeals's decision, that tribunal duly noted that information may be considered public "even though there has been no public announcement

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[5] It is worth noting that the court below cited no authority in support of this new impoundment factor nor does the Solicitor General in urging this court to let the doctrine await review in the future. Clearly, the petitioner could not have anticipated this new rule of law in his own defense nor did the trial court address it in its charge to the jury. To allow this acknowledged error to remain a rule of law until an undetermined date defies logic and all principles of jurisprudence.

and only a small number of people know it." (Pet. App. at 20a). This concession was followed by the announcement that the determining factor is not how many people may possess the information, "but whether their trading has caused the information to be fully impounded into the price of the particular stock." (*Id.*). Thus, it is evident that the Court of Appeals did not base its affirmance of the petitioner's conviction on a conclusion that the information was not widely-known, but rather on its analysis of whether the market had fully absorbed the effect of the release of the information. Absent the latter determination, the Court of Appeals would have been forced to acknowledge that the fact of wide-spread trading on the information led ineluctably to the conclusion that the information was no longer confidential by the time it reached the petitioner.[6]

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[6] It should also be kept in mind that the petitioner's conviction has had and will continue to have significant effects on his life. Although he has served the sentence imposed on him as a result of this criminal conviction, the petitioner has had judgment enter against him in a parallel

A second, equally-compelling reason to review the Court of Appeals's decision at this time is to prevent the confusion among the lower courts and circuits which this new "impoundment" element is bound to engender. The likelihood of such confusion is made evident by the fact that the petitioner and the Solicitor General cannot agree as to the effect of impoundment in this particular case. The Solicitor General interprets the Court of Appeals's decision to create an alternative means by which information can be proven to be public: either by public announcement or by price absorption. (Opp. at 14). As outlined *supra*, however, the petitioner believes that the Court of Appeals applied the

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civil action brought against him by the Securities and Exchange Commission.

In addition, the petitioner, an attorney, also faces grievance proceedings in both the state and federal tribunals where he faces possible disbarment. If the Court should agree with the petitioner and the Solicitor General that the Court of Appeals's "impoundment" theory should be reviewed, it would be manifestly unjust to delay that review and allow the petitioner's conviction to stand.

impoundment factor as an additional requirement: not only must the information be public (however publication is accomplished), but the price of the stock must also have absorbed the public's reaction to the release of the information before trading can be legitimized.

That such contrary interpretations can be drawn from the announcement of this new element does not bode well for future application of the Court of Appeals's latest pronouncement in this area of the law. Absent review of this new requirement, other panels of the Second Circuit as well as all of the District Courts within this circuit, will be bound to adhere to this new definition of securities fraud. *See, e.g., Kremer v. Chemical Constr. Corp.*, 623 F.2d 786, 788 (2d Cir. 1980), *aff'd*, 456 U.S. 461, *reh'g denied*, 458 U.S. 1133 (1982). In order to deflect unwarranted application of this erroneous interpretation of section 10 and Rule 10b-5, this Court should grant the relief sought by the petitioner.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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